

ID: CCA\_2010090118440635

Number: **201040007**

Release Date: 10/8/2010

Office:

UILC: 902.01-02, 901.02-01

---

**From:**

**Sent:** Wednesday, September 01, 2010 6:44:08 PM

**To:**

**Cc:**

**Subject:** RE: Quick question

When a foreign corporation pays a dividend to a domestic corporate 10% shareholder, section 902 treats foreign taxes paid by the foreign subsidiary with respect to the earnings out of which the dividend is paid as deemed paid by the U.S. shareholder. See section 902(a). Deemed-paid taxes include only corporate-level taxes paid by the distributing foreign corporation--taxes for which the subsidiary has legal liability. See section 902(c)(2) and (c)(4)(A). A withholding tax imposed on the dividend, even if collected and remitted by the distributing corporation, is considered paid by the US shareholder and eligible for a direct credit under section 901. See Treas. Reg. 1.901-2(f)(1). It is not included in the section 902 tax pool of the foreign subsidiary, because it is a legal liability of the shareholder imposed on the shareholder's dividend income, not a tax imposed on the corporate-level profits of the foreign subsidiary.

If, rather than withholding tax from the shareholder's dividend income, the foreign subsidiary itself pays a foreign tax that is the legal liability of its U.S. shareholder, in addition to paying out the full dividend, then under general U.S. tax principles the shareholder will have additional income in the amount of the tax paid on its behalf. This income will generally be characterized as additional dividend income to the shareholder if the payment is not compensatory or otherwise a transfer for value. The shareholder may compute a deemed-paid credit for subsidiary-level tax paid with respect to the earnings used to pay this constructive dividend. The deemed-paid credit is in respect of the additional cash dividend constructively received by the shareholder from the subsidiary that is considered used by the shareholder to pay the shareholder-level withholding tax. Because the withholding tax is the shareholder's legal liability, when the subsidiary pays the tax it is considered to have paid a dividend to the shareholder, and the shareholder is considered to have paid the tax for purposes of section 901.

When shareholder-level withholding tax is paid by the foreign distributing subsidiary in respect of a dividend or other gross income amount due the shareholder that is not paid in cash to the shareholder, but instead is retained by the distributing corporation, the amount of income constructively received by the shareholder may depend on whether the amount credited as a capital contribution is the gross amount of the original inclusion (in which case the tax payment constitutes additional income to the shareholder) or the net amount after deduction for the withholding (in which case the tax payment could be considered made out of the original gross inclusion).

Please feel free to call if you have further questions.